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No. 657

In the Supreme Court of the United States

OCTOBER TERM, 1961

KENTUCKY HOME MUTUAL LIFE INSURANCE COMPANY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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The question in this case is whether the court below erred in holding that the taxpayer realized interest income under Section 201(c)(1) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 201) when it received, partly in cash and partly through deductions on insurance policy settlements, the accrued interest for which provision was made in a reinsurance agreement executed in 1932. Under this reinsurance agreement, which was authorized by court order, the taxpayer took over the assets of the insolvent Inter-Southern Life Insurance Company and reinsured its policies (Pet. App. 30–31). Because Inter-Southern's reserves were impaired, the reinsurance agreement

imposed a lien, to bear interest at 6 percent, on the 1932 reserve on each policy to the extent of 60 percent of the net equity on the policy (Pet. App. 31–33). A policyholder was entitled to pay off the lien and interest at any time, but, if he did not do so, any unpaid balance was to be subtracted from any payment he thereafter received as a policyholder (Pet. App. 33–34). In the taxable year (1952), the taxpayer received $6,731.36 in cash as accumulated interest on the liens on the policies and, in addition, set off $61,271.28 in accumulated interest in connection with policy settlements (Pet. App. 34).

1. Taxpayer argues that the interest payments were not paid for the use of borrowed money and therefore were not true "interest" (Pet. 9–12) and that the taxpayer realized no economic benefit from the interest payments (Pet. 12–18). But, as the court below concluded (Pet. App. 39–40), the situation here is, in substance, indistinguishable from one where a policyholder secures a loan from the insurance company against his policy. Under the reinsurance agreement the taxpayer took over Inter-Southern's insurance policies (as well as its assets) without changing the policies in any way except to impose a 60 percent lien on each policy, the amount of which, plus interest thereon, would be subtracted from the amount payable to the policyholder on a settlement unless the policyholder had previously paid off the lien and interest. The result was to increase the cost to the policyholder of full coverage under his policy and to create an obligation for the payment of cash to the

taxpayer, which was accepted by all policyholders who continued their policies in effect by paying the original, regular premium. The impact of the lien was therefore no different than if the policyholder had previously paid the full cost of full coverage under the policy (the regular premiums plus the amount of the lien) and then borrowed the amount of the lien from the insurance company. Indeed, in considering the very reinsurance agreement involved here, the Court of Appeals of Kentucky has stated that "[t]he substantial effect of this agreement, of course," was to place "a loan against each policy * * *." *Kentucky Home Life Insurance Co.* v. *Leisman*, 268 Ky. 825, 828–829, 105 S.W. 2d 1046, 1047; see *Carrington* v. *Kentucky Home Mut. Life Insurance Co.*, 61 F. Supp. 424, 427 (W.D. Ky.). The economic benefit to the taxpayer is obvious, since the amount of the lien obligation, if not paid, was the amount by which the taxpayer's settlement obligations under the policy were reduced.

2. The taxpayer's other contentions (Pet. 12–26) are also without merit. The court below considered the substance of the transaction, instead of ignoring it, as the taxpayer asserts. Since the accrued interest, which the taxpayer received in cash or deducted in policy settlements in the taxable year, clearly constituted interest income to the taxpayer, both in substance and in form, the court below did not exceed the scope of its authority under the "clearly erroneous" rule in reversing the district court's finding to the contrary.

The decision below is correct; no conflict of decisions or important question is involved. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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FEBRUARY 1962.